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Case No. C-B-90-30926 ✓
Chapter 11

Debtor.

JUDGMENT ENTERED ON 4-11-91

The debtor, Wellington Charlotte Associates, is a limited partnership which owns a single asset, the Wellington Place Apartments, a 250 unit complex in Charlotte, North Carolina. The

debtor's general partner is a Michigan entity known as Uniprop. The debtor's sole limited partner is Paul Zlotoff, who is the president of Uniprop.

The debtor was formed in September 1987 for the purpose of purchasing the apartment complex, which was an older development described by Zlotoff as a "derelict property." After a period of a "false start" Zlotoff bought out the interests of two other original limited partners and took control of the project.

In January 1989 Zlotoff retained Great Atlantic Management Co., Inc. to manage the apartment complex. Great Atlantic is a long standing regional property management company with much experience in apartment management and rehabilitation. Great Atlantic, through its Regional Vice President, Glen Nalls, had "turned around" another nearby apartment project just prior to being engaged to manage Wellington Place by the debtor. When Great Atlantic took over management of Wellington Place in January 1989 the general character of the property was not good. The occupancy rate was 53%; monthly gross rents paid were about \$47,000; 40% of the apartment units had been vacant for a number of years and had been "cannibalized" to supply materials for occupied units; other units were not producing income; roofs, doors, the grounds and the property in general were in disrepair; and the quality of the tenants was low. Wellington Place was one of the oldest apartment complexes of its type in North Carolina (over thirty years old), and virtually the entire project needed rehabilitation.

By late June 1990 Great Atlantic had almost completed a major rehabilitation of Wellington Place. Four units which were partially rehabilitated remain^{ed} to be completed. Of the remaining units there were 26-28 which were occupied, and these were to be rehabilitated as they became vacant through renter attrition. This ^{rehabilitation} included new roofs for virtually the entire complex, ground improvements and maintenance, and complete interior and exterior renovation of the apartment units and buildings. While there may have been chipped paint here, some broken laundry room glass there and ugly dumpsters in the courtyard, Wellington Place was 96% leased and had the potential to produce approximately \$100,000 in gross monthly rentals.

The rehabilitation of Wellington Place was financed by three sources: Zlotoff loaned the debtor about \$2 million from 1987 through April 1990; Uniprop loaned the debtor \$154,000; and Great Atlantic used 85% of the rental income for rehabilitation costs. The rehabilitation appears to have been funded by the rental income with any shortfalls paid by loans from Zlotoff and Uniprop. It is important to note the fact that use of the rental income for rehabilitation was prohibited by the loan agreement with New West. While that was not known to Great Atlantic, it was at least constructively known by Uniprop and Zlotoff who permitted the rents to be used for rehabilitation in violation of the loan agreements while the loans were in default.

New West Federal Savings and Loan ("New West") is the successor, to the successor, to the successor of the savings and

loan association which made the initial loan to the original owners of this property (this was all a result of multiple takeovers by the FDIC/FSLIC of the original lender and its successors). The original loan was for a principal amount of \$4 million, secured by a deed of trust on the real property and an assignment of rents, and was without recourse. From the records of the various successor lending entities, New West's agent, Kris DeGraf¹, determined that the loan was in default originally in July 1987. At that time a foreclosure notice was sent to the original borrow/owner. Only then was it discovered that the property had been transferred twice -- without notice or permission of the lender. Periodic negotiations began that ultimately resulted in a CONSENT, ASSUMPTION AND LOAN MODIFICATION AGREEMENT and a MODIFICATION TO DEED OF TRUST, ASSIGNMENT OF RENTS AND SECURITY AGREEMENT between the debtor and New West's predecessor which were agreed upon in March 1989 and executed in June 1989. This modification agreement capitalized the delinquent interest into a loan with a principal amount of \$4.4 million and provided for 18 months of reduced payments. The payments were to be either \$20,000 beginning in June, graduated to \$40,000 by August 1990 or the monthly net operating income whichever was greater. The modification agreement also required the debtor to provide a rehabilitation budget of \$350,000, various monthly and annual

¹ Ms. DeGraf is an Account Officer employed by American Real Estate Group which is New West's agent for handling this account and has had personal involvement with the account only since October 1989.

financial reports, and \$5,900 monthly real property tax impound payments. Finally, the agreement expressly stated that rental income was not be used for rehabilitation of units. Although the debtor has made some significant payments, it has been in default of the modification agreement virtually from the date it was executed. The debtor's defaults included nonpayment, failure to file reports and use of rental income for rehabilitative work. In November 1989 a notice of foreclosure was sent to the debtor. Communications, talks, one payment and continued defaults by the debtor occurred over the next seven months. At present, the modified loan is \$300,000 in default.

While the debtor was under the impression that negotiations were continuing, New West obtained an ex parte Order from a North Carolina Superior Court appointing a temporary Receiver for the debtor's property on June 27, 1990. The Receiver, A.L. Green & Co., a property management company, took over control of Wellington Place on June 28. The debtor filed its Chapter 11 petition on July 3, 1990. The debtor and New West filed their respective motions, and they were heard on shortened notice on July 10, 1990.

DISCUSSION

Section 543 of the Bankruptcy Code controls turnover of property by a "custodian" such as a Receiver. 11 U.S.C. § 543. It generally requires turnover of property to the debtor with some exceptions. New West argues here that Wellington Place should not be returned to the debtor because of the debtor's

mismanagement and the uncertainty of a prospective reorganization.

New West's claim that this debtor cannot effect a reorganization is based on the debtor's history of default and its 1990 budget which shows many months with negative income and only a total net annual income of \$145,000 without making any debt payments. In spite of these contentions, the evidence at the hearing indicates that this debtor may be at the threshold of its turning point. Rehabilitation has been completed on most of the unoccupied units and occupancy is at 96%. Future rehabilitation costs will be greatly reduced because it will be accomplished over time as the remaining 26-28 unrehabilitated units are repaired as they turnover through attrition. Monthly income of \$100,000 is anticipated which would provide ample funds for operation and payments on secured debt. While this debtor's chances for reorganization may not be "bright," the court finds that they are realistic and in prospect.

New West's allegations of "mismanagement" amount to little more than the existence of defaults on the loan instruments. Although these defaults are serious they do not amount to "mismanagement" sufficient to deny turnover of this property. The debtor failed to make required monthly reports to New West. But, this appeared to be of little concern to New West (or its predecessors) since no communication records any complaint about that until a March 29, 1990 letter from New West requested specific

documents from the debtor.² That letter apparently provoked an April 19, 1990, response from the debtor which provided some financial information, but it was insufficient to meet New West's request. At a subsequent meeting New West asked for explanations and some additional information, but it never made an issue of the failure to provide monthly reports until this proceeding.

New West's inaction does not render the debtor's defaults any less serious. The debtor essentially ignored its obligations to its lender -- it failed to make monthly reports, monthly payments and to make property tax impound payments. Worse, the debtor allowed Great Atlantic to continue to use rental income for rehabilitation purposes, which it knew to be a further breach of the modification agreement. In essence, the debtor appears to have ignored (at best) or flaunted (at worst) its obligations to its secured creditor while using its security to rehabilitate this property.³ New West's (or its predecessor's) inattention to the defaults cannot excuse them.

New West's allegations about the condition of the property do not merit retention of the Receiver. The Receiver, A.L. Green & Co., is a competent company that has served this court successfully in other cases. Their actions here appear wholly

² The default in making payments prompted the November 15, 1989 notice of foreclosure. The reports apparently were not as important. New West did not aggressively pursue remedies for either default.

³ Of course, it would be expected that use of rental income would increase the value of New West's security in the real estate. But, there was no evidence presented on that precise point.

appropriate and justified. But, the court finds no merit in retaining the Receiver simply because of the alleged condition of the property.

Both New West and Green found certain deficiencies in the property when they inspected (New West) and took over its management (Green). None of these is sufficiently serious to rebut the 96% occupancy rate which demonstrates excellent market approval of the property. The Olympic sized swimming pool at the complex was closed by the Receiver and then by the county, but there is insufficient evidence that Great Atlantic or the debtor is responsible. The problems appear to have occurred as the transition in management was taking place, and no assignment of responsibility is possible on this record.

The court has concluded that 11 U.S.C. § 543 requires turnover of the Wellington Place property. The the court has determined, however, that it should not be turned over to the debtor, but instead, to a Chapter 11 Trustee. There are two reasons for this result.

First, under this court's ruling in Westchase I Associates, L.P., Case No. C-B-89-31225, (Lincoln National Life Insurance Company, decided February 21, 1990), New West perfected its security interest in the rent payments when the Receiver was

appointed. To turn the property over to the debtor might unfairly deprive New West of its perfected security interest.⁴ Appointment of a Trustee should continue that perfected security interest.

Second, the debtor's neglect of its lender is of serious concern. The debtor's conduct was more than a simple default -- it amounted to total neglect.⁵ Moreover, the financial statements produced by the debtor are, at least, suspicious and, at best, internally inconsistent. Further, there was at least one payment to the debtor for property tax escrow that was to be paid to New West by the debtor. This reinforces the need for a Trustee in this case.

The court has heard the evidence, observed the testimony of Nalls and Knows of his prior experience in this and other properties. From this, the court has concluded that Great Atlantic, in the person of Nalls, should be the Trustee of this debtor.⁶

⁴ New West's action to appoint the Receiver is likely to be the subject of an adversary proceeding regarding a preference since it occurred within 90 days of the bankruptcy Petition. No opinion is expressed about this issue.

⁵ The debtor may have had trouble finding who to talk to prior to October 1989 because of the lender's own problems and transitions. But, there was no evidence that the debtors tried to communicate.

⁶ This is to cause no adverse reflection on A.L. Green & Co., the Receiver. It and its principal, A.L. Green, III, have acted responsibly and appropriately and have provided services on an emergency basis. It is a wholly competent management company which has provided successful services in this and other cases before this court.

While the court obviously does not doubt the ability of Great Atlantic and Mr. Nalls to serve as Trustee, there is need to provide Great Atlantic with additional assistance in the performance of its duties. The court is aware of the previous close relationship between Great Atlantic and the debtor, and it wishes to avoid perpetuating the present level of distrust which exists between the debtor and New West. For this reason, the Trustee is directed to consult with the Bankruptcy Administrator and retain an attorney from among those individuals who regularly serve on this district's panel of Chapter 7 Trustees. This will ensure that the Trustee in this case will be an independent entity protecting all parties in interest, as well as providing Great Atlantic with additional expertise in Trustee matters.

The appointment of the Trustee moots the debtor's request for use of cash collateral. There is an obvious need for the Trustee to use cash collateral in the short term, however, to protect the property for the benefit of all creditors. Consequently, on its own motion the court concludes that the Trustee should be authorized to use cash collateral -- the rental income -- for ordinary and necessary expenses of operating Wellington Place. In addition, the Trustee should be authorized to use cash collateral to repair the pool and to complete rehabilitation of the four vacant units which have been partially renovated. The value added to the property by those repairs should equal the amount of cash collateral required to be used, thus adequately

protecting New West. The interim use of cash collateral will be permitted through July 31, 1990.

A.L. Green & Co. appears to be due some compensation for its services as Receiver. Rather than attempt to determine that amount at this time, the court directs Green to file a claim for its compensation. The trustee is directed to expedite that claim by either paying it promptly if it deems it reasonable, or promptly filing an objection to it if it deems the claim excessive. The court will resolve any issues about Green's compensation as quickly as possible.

It is therefore ORDERED that:

1. The debtor's motion for turnover of property and for use of cash collateral is denied;
2. New West's motion for retention of its Receiver is denied;
3. Great Atlantic Management Co., Inc., in the person of Glen Nalls, is appointed Chapter 11 Trustee for this debtor and shall have all responsibilities and powers of such a Trustee provided for by the Bankruptcy Code;
4. The debtor's property known as Wellington Place Apartments shall be turned over immediately to the Trustee;
5. The Trustee is directed to consult with the Bankruptcy Administrator and retain an attorney from among those attorneys who regularly serve on the panel of Chapter 7 Trustees;
6. The Trustee is authorized to use cash collateral through July 31, 1990, for ordinary and necessary expenses of

operating Wellington Place Apartments (including compensation of the Trustee and previous Receiver), for repairing the swimming pool and for completing rehabilitation of four vacant partially rehabilitated units, but for no other purpose; and

7. A.L. Green & Co. is directed to file a claim for its services as Receiver and the Trustee is directed to expedite its processing of that claim.

This the 11th day of July, 1990.



George R. Hodges
United States Bankruptcy Judge